



The Global Partnership on Output-Based Aid

INNOVATIONS IN FINANCE

INDONESIA



Confronting challenges with new approaches

The Global Partnership on Output-Based Aid (GPOBA) and its partners apply innovative results-based financing solutions that align incentives with impact. Our bold financing approaches help ensure that low-income households have access to sustainable infrastructure and social services needed to build stronger and more resilient communities. GPOBA collaborates with donors, governments, and development partners to bridge the financing gap and use results-based financing to leverage additional resources for greater impact.

As a Center of Expertise with an unmatched breadth and depth across sectors, GPOBA disseminates learning and knowledge, drives the conversation among thought leaders and inspires new results-based financing solutions. In that spirit, GPOBA's *Innovations in Finance* series shares financing mechanisms that can play an important role in meeting growing sustainable infrastructure and social services challenges internationally.

Through interviews with practitioners in the field, the series offers a deep dive into successful results-based financing and output-based aid projects, highlighting how novel financing approaches have accomplished objectives that otherwise would have been out of reach. This booklet spotlights the Government of Indonesia's Local Government and Decentralization Project, which was recognized with an Inn-obations Award in 2015 for its innovative use of results-based financing, capacity building, and effective governance.



WATER SUPPLY IRRIGATION SANITATION ROADS

INDONESIA

Indonesia is the world's largest island country, with more than 900 permanently inhabited islands. It was once, paradoxically, also one of the most centralized countries in the world—administratively, fiscally, and politically. Now, under an ongoing decentralization process, the central government's Specific Purpose Grants allocate specific investment expenditures that are aligned with national priorities carried out under local governments. These governments have assumed new responsibilities and begun managing increased financial resources—mostly through transfers from the central government for delivery of education, health, and basic infrastructure services.

Levels of decentralization and their related intergovernmental systems vary widely in South and East Asia. Countries have differing levels and types of subnational governments which, in turn, may have varying levels of governing power. This depends on the scale and importance of decentralization in the country as well as the scope and scale of local government mandates.

Relationships among subnational actors (more hierarchical versus more independent) also vary among the countries, as do the nature and extent of the mechanisms set up to facilitate inter-jurisdictional coordination (including within large metropolitan areas) in meeting public functions.

Various countries have made, and continue to make, efforts to strengthen the systems and mechanisms for improving the delivery of basic public services through models of decentralization—and to shape their local government agendas accordingly.

Committed to improving the lives of people living in poverty, the World Bank has been supporting a number of countries in South and East Asia in their efforts to connect poor households with sustainable infrastructure and access to basic services and improved social inclusion for more than a decade. Financial and technical support address these challenges, among others:

- Enabling proper regulatory environments for coherent functional, administrative, and fiscal devolution;
- Establishing results-based grant allocation systems for local governments;
- Supporting the structure of coherent and integrated intergovernmental fiscal transfer frameworks;
- Improving the decentralized and participatory planning, budgeting, and implementation mechanisms for service delivery; and
- Improving local governance and administrative systems.

A spotlight on Indonesia provides a useful case study of how the Government of Indonesia, the World Bank, and the Global Partnership on Output-Based Aid (GPOBA) collaborated to address these challenges with a novel, results-based approach.

It is important to note that Indonesia's "big bang" decentralization began in 2001 and constituted a tectonic shift in service responsibilities and funding from the central to subnational governments; subnational governments assumed primary responsibility for service delivery of nearly all public services.

Local government spending was, and remains, dominated by intergovernmental transfers. In 2012, over 32 percent of the Indonesian central government budget went to transfers, accounting for over 90 percent of local government budgets. Local governments' management, technical, planning, and fiduciary challenges contribute to issues regarding local public service delivery and to the efficiency of local government expenditures.

The Local Government and Decentralization Project (LGDP) represents a shift away from financing individual investment sub-projects in a small number of local governments to improving the government framework within which government grants are awarded and facilitated.

According to Thalyta E. Yuwono, Senior Urban Economist and the project team lead at the World Bank, the project originated from Indonesia's desire to employ an innovative approach to improve the transfer system so that it continued to focus on process, but placed increased emphasis on verifiable results.

Indonesia's framework for results drew on lessons provided by GPOBA and its repository of evidence and experience across multiple sectors.



By intentionally shifting the focus from activities and plans to results—verifiable results—impact is amplified by aligning incentives with services delivered.

HOW RESULTS-BASED FINANCING IS DIFFERENT

Payment

Occurs only when agreed upon results are achieved, placing the risk on the service provider

Inputs

Funding given in advance



Outputs

Funding on verified delivery of services

Advantages of Results-Based Financing

The Local Government and Decentralization Project (LGDP) helps local governments plan, budget, invest, monitor, and, importantly, verify intended results. By harnessing the power of results-based financing (RBF), incentives are aligned with impact. This performance-based financing assures results have been verified and delivered and helps drive human and economic development, today and for the future—not only in Indonesia but worldwide.

Payments from the central government happen only when the agreed upon results have been achieved. By intentionally shifting the focus from activities and plans to monitoring results, governments, donors, and development partners can ensure that impact is amplified by aligning incentives with services delivered and measurable progress in a country.

Public funding has a greater chance of being sustained when payments are linked to outputs and local governments are incentivized to deliver sustainable infrastructures and basic services. Which type of results-based approach, or combination of blended approaches to use in a given situation, is highly dependent on context.

Indonesia's Local Government and Decentralization initiative selected output-based disbursement, a form

of results-based financing, to disburse the Specific Purpose Grants.

Local governments use the Specific Purpose Grants to contract out the delivery of outputs to private contractors, but the central government can retain future fiscal transfers in the event of non-compliance, which incentivizes positive and timely local government performance. Nevertheless, the Government did not have any direct checking mechanism in place to ensure the promised outputs were delivered timely and sufficiently comply with the contracts. LGDP introduced an output verification mechanism to overcome such challenge.

The project reimburses a slice of Specific Purpose Grants expenditures to the central government from an International Bank for Reconstruction and Development (IBRD, World Bank) loan for any eligible expenditures allocated to local governments. It also reimburses the counterpart funding that local governments are required to provide to participate in the Specific Purpose Grants program. This counterpart funding, reimbursed as a block grant, acts in a similar way to an output-based disbursement.

The overall arrangement—in which financial incentives, or disbursements, are tied to the achievement of verified outputs within the scope of the Specific Purpose Grants program—supports increased transparency, with greater reliability and accountability. The project was piloted in 78 local governments (districts, city and provincial governments) of five regions

(Central Kalimantan, East Java, Jambi, North Maluku, and West Sulawesi), selected based on geographic diversity, reporting capacity, and performance and success in delivering outputs financed by their Specific Purpose Grants. After the success in those areas, by 2017 the Project coverage gradually expanded to 22 of total 34 provinces in Indonesia.

A Shift in Focus

Traditionally, World Bank projects in Indonesia have been complicated, so disbursement of funds could be complicated, too. This Local Government and Decentralization Project represents a shift away from financing individual investment sub-projects in a small number of local governments to improving the government framework within which the Specific Purpose Grants-funded investments occur.

The Indonesian government decided that if it was just reimbursing a transfer for, say, potholes, maintenance, or rehabilitation—small things, in other words—the process of reimbursement should not be—and no longer is—cumbersome.

Independent Verification Innovations

Output-based disbursement demands that results be independently verified before payments are disbursed. Prior to this project, the government had no mechanism for verifying the results of Specific Purpose Grants transfers.

The Local Government and Decentralization Project was innovative in this respect as well. They decided to use Indonesia's own National Government Internal Auditors as independent verification agents. Most of the staff trained were accountants unfamiliar with what technical specifications to check for and how to check for them. After they received training on the technical aspects of infrastructure, including quality and safeguards, they assumed responsibility for financial and technical verification of outputs.

Juliet Pumpuni, the project lead for GPOBA, who attended one of the training sessions, observed, "These participants took pride in the fact that their work resulted in good quality and durable infrastructure for their country. This training enabled them to learn and add technical quality skills to their accounting back-

ground. The result? A win-win all around with better quality verifications, contractors committed to following contract specifications to a tee, and better quality and durable infrastructure for the communities."

She continues, "What makes quality work possible is the strong, autonomous, and professional cadre of auditors from public institutions. In addition, there is national and professional pride, a commitment to poverty reduction, a national commitment for excellence, strong institutions, and funding for continuous learning and capacity building from GPOBA's technical assistance training."

Trained staff are provided with an Independent Verification Agent toolkit that includes a checklist with sections on procurement, financial management, safeguards, and technical issues; each infrastructure sector has its own indicators. Using these verification checklists, the staff approve reimbursements based on achieved outputs.

The verification agents provide timely and accurate reports from randomly sampling at least 20 percent of reported outputs in each local government. If they determine a project is ineligible for reimbursement, the detailed report contains feedback and recommendations. This helps the local governments improve their management, performance, and implementation of Specific Purpose Grants in the future.

Although some local governments originally did not see the value of compliance with project regulations, (in procurement or social accountability for example), they now see this process results in more efficient and effective projects with the in-need public as the true beneficiary.

Riono Suprpto, Head of Local Infrastructure Financing Facility, National and Multilateral Cooperation Bureau, Secretariat General of The Ministry of Public Works and Housing, describes the results this way, "This project provides added value and benefit for the Ministry of Public Works by presenting the pictures of technical performance, governance, and capacity within project management in the local governments."

Expanding to Other Sectors

In the four infrastructure sectors in which the project was piloted—water, irrigation, sanitation, and roads—established technical guidelines existed that didn't change greatly from year to year. Although output-based



The output-based approach is an innovative project design to leverage outcomes. In this project, we integrated the output-based disbursement into the government system. This concept is very challenging to implement, but has proven its sustainability as well as its institutionalization process.

DENNY KURNIAWAN

Head of Local Transfer Section I, Directorate General of Fiscal Balance of the Ministry of Finance

disbursement need not be limited to infrastructure sectors, they were a natural place for this project to start. Now, the Ministry of Finance is using verification checklists for other sectors, replicating and adjusting it as needed to address the technical issues and indicators.

There is a clear opportunity and interest to use results-based financing in the social sectors. Already, Yuwono says, the Ministry of Public Works has become a model for other line ministries, and clients are looking to replicate output-based disbursement.

Health and education are the two biggest recipients in the intergovernmental transfer system, and a project using an output-based or payment-for-results approach has the potential to improve outputs without becoming bogged down in the process.

Enhancements Continue

Embedding output verification mechanisms within Indonesia's National Government Internal Auditor and existing systems will continue. The current institutional

arrangements are strong and are working within an established government system. Assuredly, verification training will continue. The goal is that by the end of 2017, all local governments will be using output-based disbursement in infrastructure sectors.

Putut Hari Satyaka, Director of Fund Balance of the Ministry of Finance of Indonesia, explains that the tool itself will continue to evolve. "Up to now the focus has been more on outputs than outcomes, but in the future there will be greater emphasis on indicators. By focusing more on outcomes, the next step should ensure not only efficiency but effectiveness. We are setting up specific indicators—for example, with roads—that move from procurement to how roads really can give more access and distribute more goods, lowering the price of distributions, and so on. So the indicator would be accessibility."

The longer-term future of the approach will be supported when it is inscribed in the country's regulatory framework. The updated version of Law 33, which is currently being revised, will include a mechanism for monitoring and evaluation that is modeled on output-based disbursement as used for Specific Purpose Grants.

The Next Steps of Innovation

GPOBA's work with the Local Government and Decentralization Project (LGDP) has produced positive results that will be replicated in other countries. As of early 2017, over 350 National Government Internal Auditor staff have been trained in 22 Representative Offices in Indonesia.

To ensure that knowledge is retained and shared within the National Government Internal Auditor offices, training methodologies are being institutionalized within their Training Center curriculum—this includes creating online learning, which will enable replication of the technical training for wider audiences throughout Indonesia and beyond.

The training and toolkit materials provide additional opportunities and incentives for other governments to participate, as strengthening their own capacity can help them to mitigate performance risks. To this end, a Knowledge Exchange event held in India in May 2017 provided the Indonesia team with an opportunity to share their insights and lessons with representatives from Bangladesh, India, Nepal, and Sri Lanka; the GPOBA team is looking forward to supporting other sectors and countries.

Catherine Commander O'Farrell, Head of GPOBA, sees output-based disbursement as an innovative tool for developing countries that have solid institutional arrangements in place. What advice does she give to those considering initiatives similar to Indonesia's? "We always stress the importance of working closely with clients to carefully determine the potential for results-based financing and the approach that is most suitable for their needs and country context. The government's own existing systems need to be assessed. Enabling regulations, governance, procurement, internal control, and sector guidelines need to be analyzed. Making clients aware of the factors needed for results-based financing and output-based aid to be successful is key to effective design, implementation, and provision of services to low-income communities."

LGDP, with its instrument of output verification, was able to capture the Local Government performance in implementing DAK infrastructure. It informed the Ministry of Public Works and Housing design the targeted capacity building program for these Local Governments". Fajar Eko Antono, Local Infrastructure Financing Unit, Secretary General of The Ministry of Public Works and Housing.



Independent Verification Agent Toolkit

- ✓ Complete the verification checklist.
- ✓ Use the checklists to measure outputs and verify the quality.
- ✓ Approve reimbursements when the outputs are achieved.

Verification Checklist



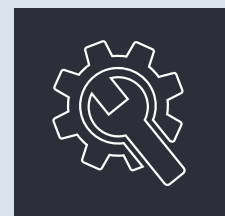
PROCUREMENT



FINANCIAL
MANAGEMENT

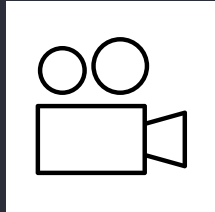


SAFEGUARDS



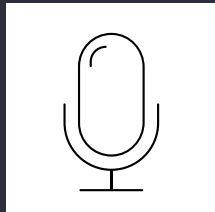
TECHNICAL ISSUES

Additional Resources



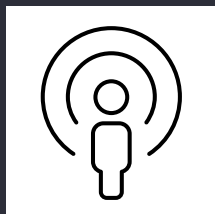
Results-Based Financing: What's So Different About It?

Results-Based Financing to Deliver Urban Sanitation Services

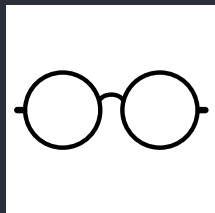


Instituting a Framework for Quality with Web-Based Reporting Systems

Instituting a Framework for Quality with Independent Verification Agents



RBF/OBA Community of Practice



Getting Results: Independent Verification in Output-Based Aid



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